DOW THEORY LETTERS INC.

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Feb 14, DJIA 734.20; PTI 233; A-D ratio -29.21
Feb 21, DJIA 749.77; PTI 251; A-D ratio -29.03
(Note: I am dropping the composite chart of the various Averages. I don't think it is needed at this time.)

First Clown: What do you think this market could do to make damn fools out of us all? Second Clown: Well, I guess if it kept right on going with the Dow pushing through the old 1051 high, that would make a fool out of just about everyone. I have only a few shares of stock, so it would sure make me look like an idiot. First Clown: Through the old high, are you kidding? I sold all my stock around last year's lows, and — say, you don't really think it could go through 1000, do you?

TECHNICAL PICTURE: I have a sheet on which I keep daily tabulations on eight market catagories. They run like this: (1) D-J Industrial Average, (2) Transport Average, (3) Utility Average, (4) D-J 40-Bond Average, (5) Primary Trend Index, (6) Advance-Decline Ratio for the NYSE, (7) A-D Index for the 30-Dow Industrials, (8) Cumulative Most-Active Stock Index.

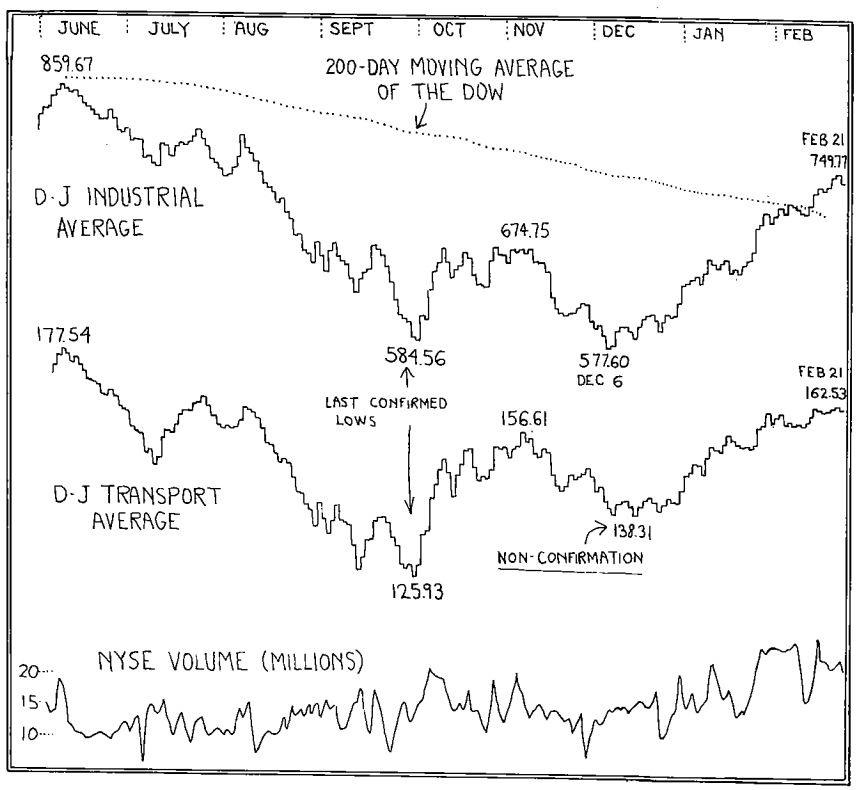
During the late bear market I kept downside listings. In other words, each time one or more of the above catagories hit a new bear market low, I would label it as another gold star for the bear. Often I would get three or four new lows in a single day. And occasionally we would have a powerful clean sweep. That would represent a technical triumph for the bear, with all eight catagories recording new bear lows.

In December of 1974 I decided to reverse the process. I started keeping a listing that showed new recovery highs in any of the eight catagories. The statistics were hopeful during early January. From mid-January on, the tabulations turned rampantly bullish.

To give readers an idea of the strength of this primary bull market, let's see what has occurred. Since January there have been five separate days in which all eight of my catagories have hit new bull market recovery highs. These clean-sweep days occurred on January 10, January 27, January 29, and on February 20 and 21 (last week). Thus the power, the grinding, relentless accumulation, the brute force of the bull market continues unabated. Here we are, still in the buying stampede. And yet, after almost two months of uninterrupted upside progress we get two tremendous technical performance-days (Feb. 20, 21) with all eight of my catagories at new recovery highs. EVERYTHING confirmed on the upside.

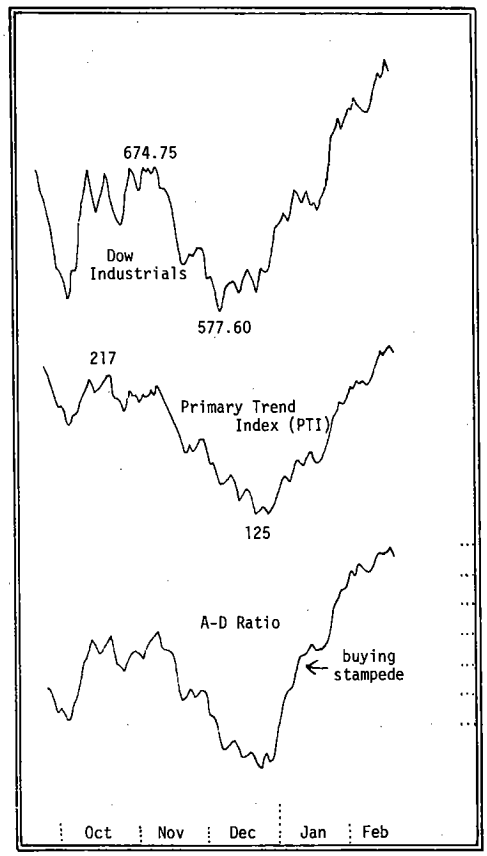
To top it off, after the close (Friday) February 21, it was announced that the short interest on the NYSE jumped 25% to a total of 25 million shares, an all-time record! What is so significant about that? First, remember that since 1966 the short sellers have been with the primary (bear) trend; they have been positioned with the market. Not so today, for we now have a staggering total of 25 million shorts on the wrong side of the market. They are positioned against the strongest force in the market, the primary (bull) trend.

But just as important, the current record short interest tells us that people are fantastically skeptical about this bull market, and that instead of clearing out their shorts and buying stocks, they have used the advance since December as a "golden opportunity" to put out shorts. The result of this misguided thinking (and acting), this positioning against the primary trend, should be an upward explosion during the months ahead.



With a confirmed primary bull market, with the Dow now well above its 200-day moving average, with the odd lot public selling heavily, with the short sellers trapped in an orgy

of their own pessimism, we have a big bull market which (I believe) is about to astound the investment world and shock the public. My feeling is that 1975 could see one of the most bullish performances since 1958, a year when the market climbed a wall of worry a mile high, a year that saw huge profits for the bulls while the short sellers were virtually destroyed (veteran readers may remember that the economic news and the prevailing sentiment in 1958 was, if anything, blacker than it is today). And older readers may also remember that 1958 was a year when we made tremendous profits in the cyclical issues, the steels, the oils, the building stocks.



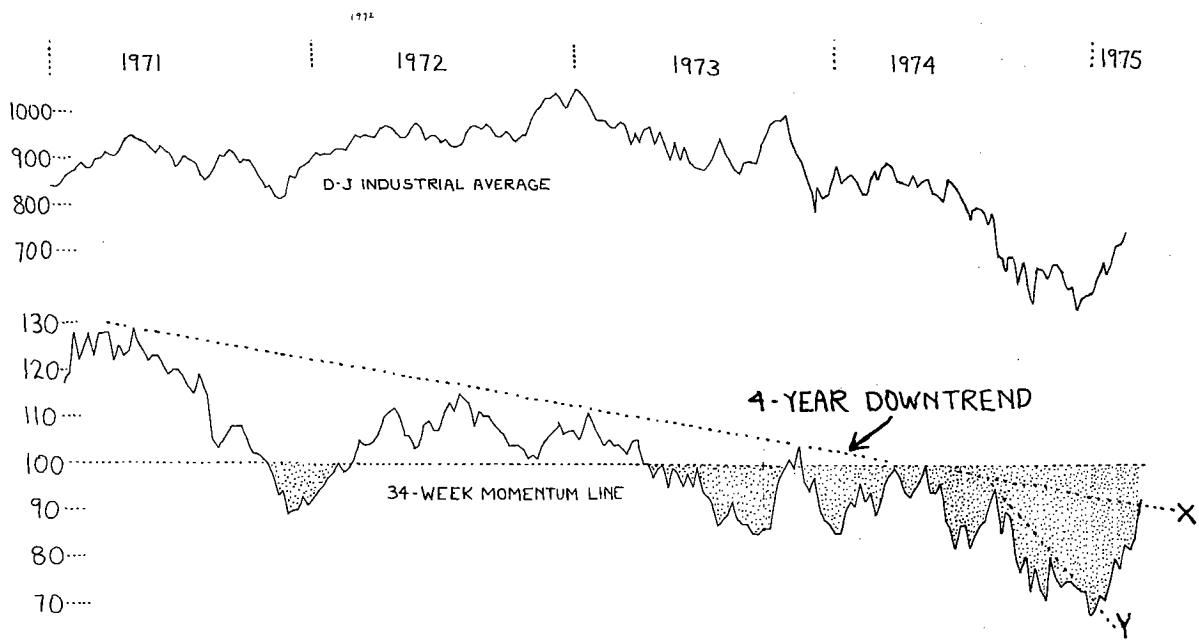
NEAR-TERM: I have included my daily chart of the Dow Industrials, the Primary Trend Index (which is my own technical invention) and the A-D ratio for the NYSE. Since late-December both the PTI and the A-D ratio have been doing a masterful job of leading the market to higher levels. If there are any signs of danger, I cannot find them at this time.

The great buying stampede, a phenomenon which I have been discussing in detail ever since Letter 619, is still intact. Referring to the chart, the dotted lines to the right of the A-D ratio denote gradations of 1 point each. As long as each decline in the A-D halts within 1 point of the preceding high, the first phase of the buying stampede will remain in force. How long can the buying stampede last? I don't know, but the indications as of this writing are still bullish for the upside. Odd lotters are now selling at the highest rate in 1975, roughly 15 shares sold for every 10 purchased (and this ratio has been increasing as the market works higher).

We do have the 1960-61 precedent, in which a single buying stampede lasted 93 days (the current stampede is now 41 days old). We also have the remarkable three-phase investment stampede of 1958 that carried from early April to November, a period of seven months. Obviously, there is no guarantee that history will repeat, but there is also no certainty that it can't. Remember, a primary movement is a law unto itself, and when a primary swing is in progress (bull or bear) the market can do what it wants, when it wants and the way it wants.

One more point here: I am as aware as the next man that the market by all "normal" standards is now overbought. Yet just as a bear market can stay oversold for months (and we saw that all during 1974), a bull market can stay overbought for months. This bull swing has developed following the greatest breadth (A-D) crash in market history. It stems from an unbelievable 18 years of decline in the A-D ratio (1956 to 1974). When I tell you to expect ANYTHING on the upside now, I'm not just being cute and whimsical, I'm saying ANYTHING.

MOMENTUM: I last reviewed the momentum study of the Dow in Letter 617, page 4 (Dec. 13, 1974). The Dow momentum that I use is based on a 34-week span, and the weekly figure is derived by dividing each Thursday's closing by the same figure 34 weeks ago. The momentum chart shows us a series of ratios. A rising series of ratios indicates that the Dow is advancing compared with its movements of 34 weeks ago. And if the rising ratios are above zero the momentum is telling us that the Dow is not only above its price of 34 weeks ago but advancing at an increasing rate. The converse is true if the momentum is dropping, and if the momentum line is below zero and dropping it means that the Dow is below its price of 34 weeks ago and dropping at an increasing rate.



In Letter 617 I noted that the momentum line for the Dow had been declining on a trend basis (see chart) for four

years, or ever since 1971. On an historical basis, there have been only four periods in the past which compare to the 1971-1975 period for duration of declining momentum. These four periods were 1901-1904, 1905-1908, 1929-1932 and 1936-1942. Thus, the period of 1971-75 is the second longest period of declining Dow momentum in history. The severity of the decline is also apparent when we realize that the October, 1974 low of 58 represented only the third time in modern history that the momentum index broke under 60 (the three "under 60 figures" occurred in the years 1932, 1938 and 1974).

Note that the momentum line swept below zero (shaded areas on the chart) on three occasions since 1971. Each of the areas was deeper than the previous one. It seemed to me that the latest area (1974) took on a climactic look, and this is one of the factors that put me on the bullish path. In Letter 619, page 2 (January 2) I wrote "Last Week the 34-week momentum line turned up through a secondary declining trendline. The downside momentum in the Dow appears to be ebbing." I have labeled that secondary trendline with a Y while the major declining trendline is labeled with an X.

But the reason I am reviewing momentum at this time is that we have just seen a most exciting technical development. Last week (Feb. 21) the Dow closed at 749.77. That closing resulted in the Dow momentum penetrating its descending trendline X for the first time since 1971. This reversal means that the force, the great thrust of the market is once again pointing upwards. I can only liken it to a foot soldier who, having carried his 40-pound field pack through miles of exhausting combat territory, throws it off, fixes his bayonet, and prepares to fight. That is where the bull is now. He is prepared to have things his way for a change — as the bears will soon find out.

THOUGHTS: I received a letter last week from Mr. A. C. Dunbar, News Editor of Canada's leading business newspaper, the Financial Post. Mr. Dunbar says that (contrary to my observations) at least one publication is calling this "a bull market." To prove it, Mr. Dunbar included a copy of the February 1 Post, and there on the front page the newspaper does indeed announce a new bull market (with credits to Dow Theory Letters). The February 8 edition of the Post goes even further; it takes note of the explosion in both the New York and London markets and headlines it, "Market Decides to Cancel the Apocalypse."

The Post may be nearer the truth than its capricious headline suggests. But of course the market itself didn't cancel the end-of-the-world show, the market merely sensed (and signaled) that the show would not be seen over the foreseeable future. What could the market have sensed? What facts has the mysterious intelligence of Wall Street uncovered?

I can only guess, but here are my guesses. First, the world is drowning in oil, and one way or another oil prices are coming down. Last week it was announced that the American owned Trans-Arabian Pipeline Co. has stopped pumping Saudi crude oil to its terminal 35 miles south of Beirut. Why? Because it has no contracts to ship for the next six months! A spokesman said that tanker shipping from the Persian Gulf runs $2 a barrel lower than pipeline oil, and there isn't even enough demand to keep the tankers going. The overall fact is that 30% or almost one-third of all OPEC pumping facilities are now out of operation. That represents a major shutdown. As friend, Eliot Janeway, puts it in his latest Janeway Service report, "The OPEC price structure was never as firm as it was cracked up to be — even at the worst of the embargo scare. It is now coming apart at the seams."

In the meantime, it's an open secret that all kinds of deals are now being made with the OPEC countries at under-the-market prices. And despite the huffing and puffing of OPEC, there is no question that oil, like American autos, is subject to the law of supply and demand. So that is one of my deep suspicions, the price of oil is coming down.

Suspicion number two is that there will be a mid-East settlement between Israel and the Arab nations. Already, Iran has stated that she will supply Israel with oil as part of a mid-East settlement. Israel (I believe) knows that the best she is going to get from any deal is a US guarantee of existence and survival (with Arab agreement on this) in return for much or all of the occupied Arab territories. In the end, Israel will agree.

If the Arabs do not "get it together" with a settlement of both Israel and the oil question this is what I think they will hear (actually I believe they have already heard it). United States: "Look, friends, we're paying through the nose for your oil now, and it's very depressing to say the least. Our economy has been hit hard, and our balance of payments is atrocious. But, er, we'd like you to remember a few items. First, should this emergency deteriorate further, we will be forced to defend ourselves. This could entail a series of shocking events, gentlemen. It could entail events so shocking that none of you sitting here would ever return to your plush life and, er, liberty as you know it. As for Israel, we can handle her if you will just be reasonable. If not, well, as they say, the Israelis have a very effective army, which, we might add, has been contained only through US 'advice'.

"Now, gentlemen, we know there is an oil glut. We do not want to tell you how to run your business, but let's put it this way. The US would take it very kindly if you would allow the law of supply-and-demand to operate as we move along in this world economic crisis. Remember, the US is basically a business-oriented nation, and you can understand that, gentlemen. In other words, we want to do business. But the Russians are politically oriented, and they want to extend their political er— sphere.

"So help yourself, buy a piece of Pan-Am, buy a bank here, a hotel there, enjoy, invest, buy our Treasury bills, rest, sleep well at night. To make a long story short, we feel it will be very much to your interest to 'go along' with us, and, er — rather quickly."

Suspicion number three is that the market is correct, that it knows exactly what it is doing. It is discounting an end to recession in the US during 1975. The market is seeing through what Newsweek calls "Apocalypse Chic" (see clip, page 4). Personally,

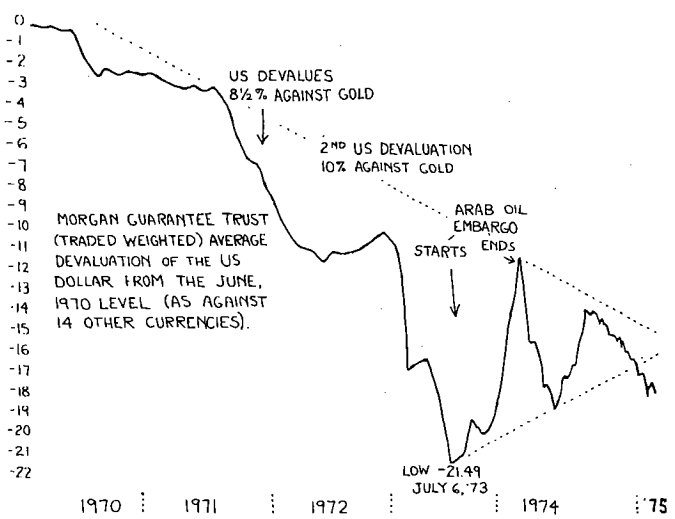
I don't think the current black sentiment is going to prove correct. Informed money is using today's depressed psychology to buy corporate stock at 30¢ on the dollar. If or when we really do go over the edge of the cliff, my bet is that public sentiment and the newspapers and magazines will be saying "It's all OK, it's a false alarm, we've seen this before." But when that happens, my bet is that events will be moving ahead of sentiment, both in the market and in the economy. Today, my feeling is that the sentiment is blacker than the facts.

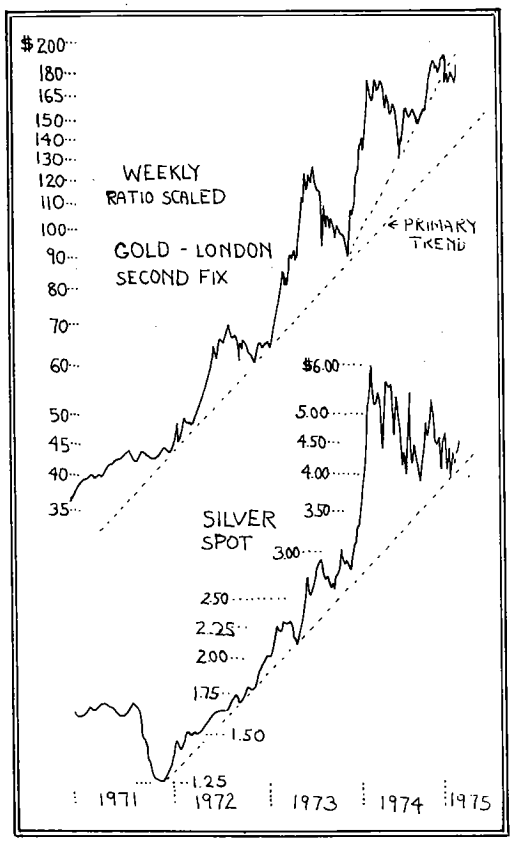
Question: Russell, when do you foresee a turnaround in the economy? You talk about a turn sometime in 1975. Big deal, when in 1975? Answer: On August 17 at 2pm. Seriously, that really isn't your concern unless you are a businessman. For businessmen, I'd say that the worst will probably be seen by mid-year, but the upturn could be ragged at first, then strong and perhaps even frothy during 1976. But for investors, it's probably going to be a tricky story. For instance, my intuition tells me that this bull market could be two-thirds over by the time the economy actually turns up. How would that be for a fooler! Care for an even worse fooler? The business recovery takes much longer to materialize than expected; say business doesn't turn up until late 1975 or early 1976. And lo — the market tops out with the first signs of recovery. But those are just idle fantasies.

Apocalypse Chic

It used to be that the only people who cared about doomsday were fundamentalist preachers who peddled gloom as if they owned a piece of the Apocalypse. Today, however, Americans can hardly pick up a newspaper or magazine, tune in a talk show or go to a movie that does not trumpet disaster. In The New York Review of Books, historian Geoffrey Barraclough recently outlined the grim prospects for "The Coming Depression" and "The Great World Crisis." The New York Times comprehensively detailed the spread of famine in India and Africa in an extensive series on the world food crisis, while Commentary magazine published an article advancing the plausibility of a U.S. military take-over of Arabian oil fields.

All of which is why I say, let's stay with our market studies. Economists usually don't make money in the market. And don't be too hard on the recession. My feeling is that the bad news is keeping the public away from Wall Street while at the same time it is keeping the market technically strong. Remember, the public does not like to buy in the face of a scary economic picture. When the economy finally does turn up, stocks may well have discounted the greatest part of the "good news."


US DEVALUES 8½% AGAINST GOLD
2ND US DEVALUATION 10% AGAINST GOLD
ARAB OIL EMBARGO STARTS
ENDS
MORGAN GUARANTEE TRUST (TRADED WEIGHTED) AVERAGE DEVALUATION OF THE US DOLLAR FROM THE JUNE, 1970 LEVEL (AS AGAINST 14 OTHER CURRENCIES).
LOW -21.49 JULY 6, '73
1970
1971
1972
1974
'75



GOLD: The dollar has been weak, as my chart of the average devaluation of the dollar against 14 other currencies shows. Over the past few months the dollar has been particularly weak, dropping around 7% against the Swiss franc. The strange part of the story, however, is that gold itself hasn't been that strong. In fact, gold has actually declined against the Swiss franc since December, which may explain why Europe is not more enthusiastic about gold at this time.

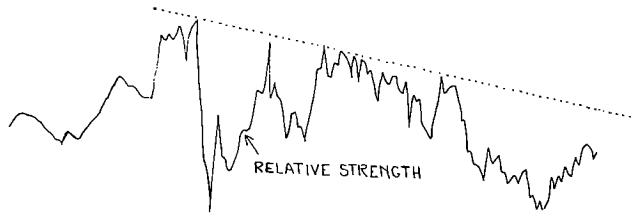
My chart of gold and silver (weekly) shows gold breaking below its steeper secondary trendline but still holding far above its long-term or primary trendline. On a shorter term basis, my gold momentum line (13-week) broke down in December and last week gold dropped to 99 on the momentum index, which means that bullion is now below its price of 13-weeks ago.

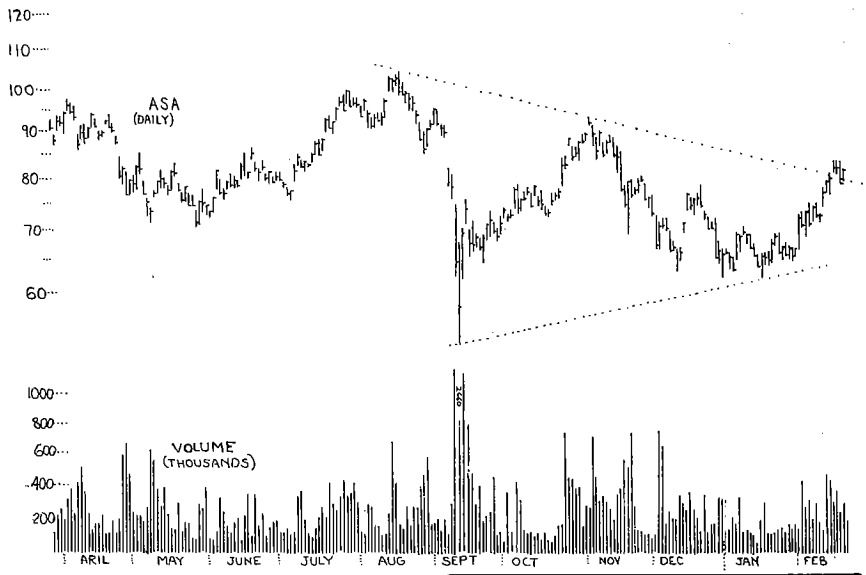
Silver, the "mystery" metal, dropped back and touched its primary trendline in late-December, and since then it has bounced up into the $4.60 area again. Whether the long descent from the 1974 peak of $6 is a massive consolidation or something more serious we cannot know at this time. But as long as silver (as with gold) holds above its primary trendline, I would give it every benefit of the doubt and call it bullish.

The gold shares are as mystifying as silver, to my mind. The leading listed gold shares such as Campbell, Homestake and ASA have broken down in relative strength or relative performance against the market. I include a monthly chart (page 5) of Homestake (HM), and here we see the cracking of the entire rising relative strength trend since 1974. As so often happens on a relative strength crack, the stock (and the group in this instance) has rallied, but note on the chart that the rally has taken place below the trendline in

the actual stock while the relative strength line has hardly budged upwards.

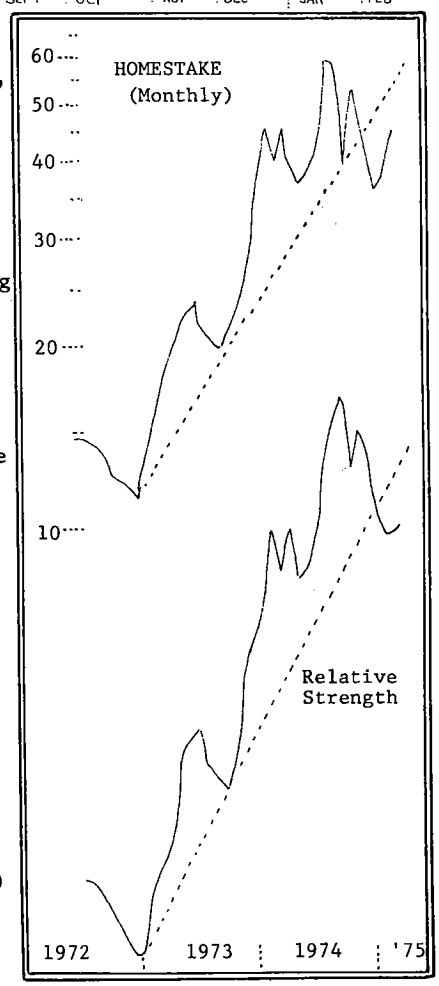
On a shorter term basis, my daily chart on ASA and HM have broken out of large triangles to the upside, and I have included the ASA chart here. Note, however, that there was no volume expansion on the breakout, following which ASA dribbled back into the triangle area again. What does this mean? I feel that it is too early to tell, but I simply have not been impressed with the performance so far. One of the things I will be watching for is to see whether ASA's relative strength line can push through the trendline. Until it does, the conclusion is that the golds (despite inflationary expectations) have not been keeping up with the rest of the market.





I would suggest sitting tight with whatever golds you now have as well as any gold bullion or coins. The picture is still not clear, and I don't like to jump in a fog. By the same token, I would not leap into the gold picture either. I do feel that there has been a good deal of hedging with gold shares on the part of traders ("This market's going to topple, and I might as well switch into a few golds"), and for this reason the action of gold shares should be most interesting during any general market decline that materializes in the period ahead.

On a fundamental basis, it is well to note that the gold shares in general topped out in August, 1974, with the price of gold in the mid-150's. From their August peaks, gold shares suffered major declines, in many cases declines of over 50%. But gold bullion never weakened (just a minor dip into the $140's in September), and bullion now stands $30 above its August, 1974 level. Therefore, it is entirely logical that the shares could be adjusting to the higher price of gold as well as still recovering from their panic 1974 slides.



It's where the gold shares go from here that should be interesting. Many of the leading mines now sell on a good yield basis. On the other hand, wages and cost for the gold mines are rising rapidly. Therefore, time will exert a pressure on the gold mines unless the price of gold moves higher, thereby making up for increased labor costs (which in S. Africa have been rising at a rate of almost 25% per year).

STOCKS: I recommended US Steel in Letter 621, and I want to review the stock again now. One of the things that tries my patience is laying out these reports, and I am always hoping that the charts and the writing will jibe so that it can all be on the same page. Alas, it's never that easy so please turn to page 6 which shows two charts of "Big X." The point & figure chart is a five-point reversal affair, showing all rallies and declines in "X" since 1914 (talk about long-term!). We can thank James Dines and his Crosschart book for this one (Crosschart, 18 E. 41 St., NYC 10017).

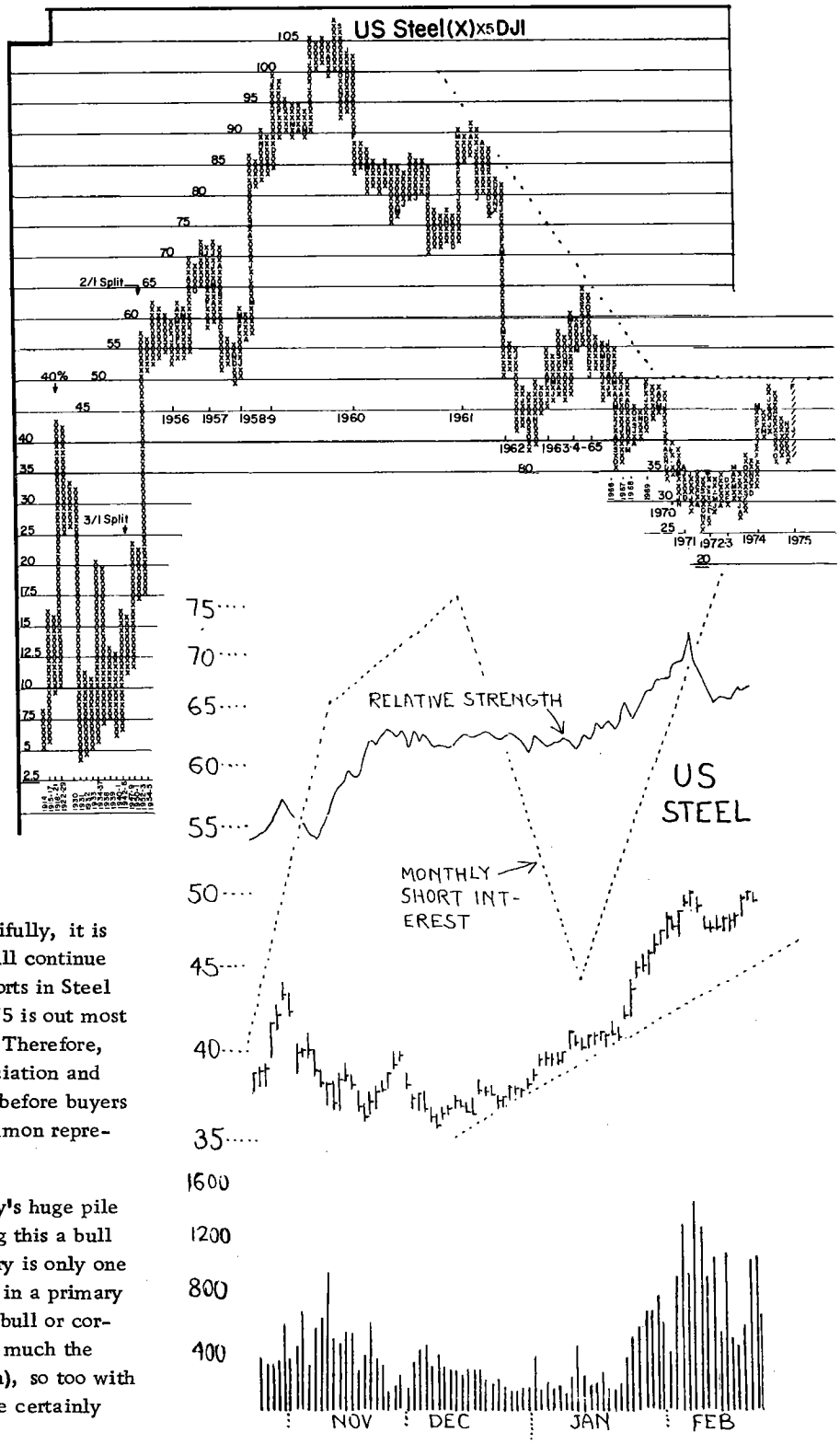
Here we see the great rise in X from its 1932 low of 4 to its 1959 high of 108. From there X entered into a withering bear market that by 1971 saw the stock lose over 75% of its value as it sank to 25. At 25 Big Steel was below anything seen since the early 1950's and far below book value. When Wall Street turns bearish on a group, they send it to the Lower Depths for years, and X was no exception.

Nevertheless, as you can see on the chart, not everyone was bearish on X. Accumulation began in 1966, followed by a rally to 50. Then came the sickening plunge to 25 in 1971, followed by a long period of accumulation during 1972 and 1973. So strong was this accumulation that Big X actually set higher bottoms during the disastrous years of '73 and '74. It was also during 1974 that X broke or reversed the long downtrend line connecting the 1961 and 1970 tops.

But what I find most exciting about X is the massive head-and-shoulders bottom that has now formed in the stock, a bottom stretching across eight years! It is my feeling that this huge bottom represents enough accumulation to make US Steel one of the outstanding performers of this market in the months ahead.

Now turn to my own daily chart of X. Here we see the action since late-October as the long bear market on Wall Street was breathing its last. In December X started up, moving from the 35 area in late November to 50 in February. I have drawn a trendline to mark the angle of the Steel advance. At 50 X halted amid rising volume, dipped to 47½, then hit 50 again. This time the market turned down (Feb. 23) and X backed off a bit, but only a bit. All of which takes us up to the present.

I have shown the relative strength line, and here we see that X continues to act better than the market. Finally, the short interest (shown in thousands) is building in X, with the latest or mid-February short interest having jumped (actually doubled) to a total of 82,000, highest reading in years.



My conclusion: US Steel is performing beautifully, it is acting better than the market, I believe it will continue to act better than the market. I think the shorts in Steel are going to be wrong, and I think before 1975 is out most of the shorts are going to be driven to cover. Therefore, I suggest positions in US Steel for both appreciation and dividends. I feel it is only a matter of time before buyers discover the outstanding value that Steel common represents at this time.

LATE NOTES: I've been going through today's huge pile of mail. There's a lot of objection to calling this a bull market. Harry Schultz stated that Dow Theory is only one of the tools he uses and writes, "I say we are in a primary bear market with a normal interruptive baby bull or corrective counter action...." Jim Dines feels much the same way, so does the Consultant (Ike Hasson), so too with Bill Schaefer. If we're in another 1930, we've certainly been forewarned.

I believe that we're in a primary bull market. I don't know how it's going to work out, except that it's going to be difficult, like all the other bull markets, and it's going to provide plenty to worry about. Right now the market is making corrective noises. Every primary movement in the history of the Averages ultimately undergoes something like a one to two-thirds correction. This rise will be no different, I guarantee it. The only question, the question none of us knows now — is when. New highs in the A-D ratio confirmed by new highs in Industrial and Transports always make breathing easier. Monday (Feb. 24) started off with a downward thud of 12 points in the Dow and about a third of a point on the A-D ratio. The first day down seldom tells the story, and if we're correcting, it will have to be an unfolding story. Nothing's unfolded yet.

The best action for the market now would be a sideways or corrective movement on lower volume. With 25 million shorts in NYSE issues, declining trading volume with prices tending to hold would build a tremendously strong technical situation.